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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

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PUBLIC UTILITIES
COMMISSION

---In the Matter of ---

PUBLIC UTILITIES COMMISSION

DOCKET NO. 05-0002

Instituting a Proceeding to Investigate
the Issues and Requirements Raised by,
and Contained in, Hawaii Revised
Statutes 486H, as Amended.

ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS

DATED: Fairfax, Virginia, June 17, 2005

Thomas W. O'Connor
Project Manager
ICF Consulting, LLC
9300 Lee Highway
Fairfax, Virginia 22031

ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION REQUESTS

Docket #05-0002

CA-IR-1

Ref: ICF Report

Please state whether, in ICF's opinion, the PUC should make any departures from the analyses and recommendations in ICF's April 15, 2005 report.

Response: Yes. As a result of the continuation of the PUC's process to arrive at the most effective approach to the Hawaii Gas Cap legislation through the sessions in May to question the ICF report and incorporate input from Parties', ICF would make a number of departures to ICF's recommendations.

While IR-1 does not specifically request ICF to identify the areas of departure, ICF notes below the areas where ICF would modify the recommendations in the Report. Please note that ICF may have additional areas of departure as the process continues.

1. ICF would include an inventory carrying cost in the import parity calculation based on an additional three week supply held "on the water". This cost would float with baseline prices, and would be about 0.35 cpg in today's market.
2. ICF would recommend an adjustment to the marketing margins to reflect relative land value and rent caps in Hawaii vs the Mainland markets evaluated. Determination of this factor would require further data and analysis than ICF had for the report.
3. ICF would recommend not imposing gas caps on the Bulk class of trade
4. ICF would consider, with Parties' endorsement, eliminating the Unbranded Rack class of trade
5. ICF would incorporate an adjustment for potential increases in the Panama Canal fees, import duties, etc when those may change
6. ICF would correct Exhibit 4.11 by utilizing all non-rounded results
7. ICF would correct tariff assumptions for Rack margins in Atlanta and terminalling costs in Phoenix, which both were understated by 1 cpg. ICF would also evaluate Seattle margins using the Portland spot market in lieu of the Seattle barge market as a cost basis.

In addition, ICF raised concerns in the Report about both the Ethanol mandate and the Small marketers (related to remote locations). The sessions in May, and the Parties' questions to ICF in both matters confirm that these are issues which should be addressed. ICF concurs that the Ethanol mandate will create a need to modify the Gas Cap structure, and the small marketer impact will occur immediately (September 1 and later).

ICF believes the scope of the Ethanol issue, and the time to fully understand the impact on Ethanol cost, supply and storage is a basis to recommend to the PUC that the Gas Cap implementation be initiated on a "calculation and monitoring" basis until the Ethanol mandate is in place and functional. This also provides more time to understand the small marketer impacts.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-2

Ref: Page 25, Paragraph 1.

- a. Please state whether information became available to ICF regarding transactions between Hawaii refiners and bulk customers done on an "import parity" equivalent and whether ICF reviewed such information in the context of their recommendations.
- b. Please also state whether, in ICF's opinion, a negotiated bulk sale price could somehow be used as a proxy for import parity rather than a speculative "appropriate" baseline plus location adjustment. If yes, please explain how this should be accomplished.

Response:

- a) ICF saw several formulas for import parity. These formulas were received in late March, well after ICF developed its own recommendation. ICF did review this information and found it to be reasonably close to the ICF formula in terms of bottom line import parity price. Recognizing that ICF's Bulk sales price includes a 1 cpg cap, the two formulae were 1 and 5 cpg above ICF over the 6 years, and, in 2004, ICF was higher than one by 2 cpg, and lower than the other by 1 cpg. One of the formulae was extremely close to ICF; the other involved different price points and was very volatile.
- b) No. First, ICF does not believe the formula is speculative, since it mirrors results of negotiated contracts reasonably well. Second, given that there are several mechanisms used by Parties, a decision to use one vs. another would be clearly unfair to the other Party.

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**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-3

Ref: Page 19.

- a. Please state whether, in ICF's opinion, a premium should be added to the Platt's Singapore and USGC prices recognizing that importers without a contract will pay a premium on spot purchases.
- b. If yes, please explain how this should be accomplished.

Response:

ICF does not think an importer without a term contract will pay a premium. The Platt's prices reflect the ongoing spot market, not a term contract market.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-4

Ref: Page 19.

- a. Please state whether, in ICF's opinion, there should be an incremental adjustment to the base gasoline price to cover additional import costs such as financing, inventory carrying costs and administrative costs.
- b. If yes, please explain how this should be accomplished.

Response:

- a) Yes, there should be an incremental adjustment to the base gasoline price to cover additional import costs such as financing, inventory carrying costs and administrative costs.
- b) ICF did not address financing, administrative, or inventory carrying costs in the import parity determination because, based on experience, these factors are normally not part of a decision process to determine the economics of a gasoline cargo movement between locations.

However, since the analysis for Hawaii was focused on assessing the ongoing import parity of gasoline into Hawaii, a case could be made that the process would require an additional volume of inventory "on the water" because of the import assessment. ICF is not persuaded that additional "in terminal" inventory would be needed, as the imported volume in terminals would in effect replace refinery inventory (in addition to finished gasoline, there would be no inventory tied up in component blending tankage either).

The calculation method to determine the cost would involve an assessment of interest rate and wholesale gasoline price to determine the carrying cost. Financing and administrative costs would be much smaller (ICF believes most companies importing into Hawaii would not require posting a letter of credit to back a purchase). To keep the overall analysis of import parity with the minimum number of moving parts, ICF would suggest that this factor be determined and updated annually.

A typical inventory carry cost in today's market would be estimated to be .35 c/gal. The following assumptions were used to calculate this:

LIBOR rate: 4% (actual current 6 MO LIBOR rate is 3.540)

Wholesale Gasoline Price: \$1.50/gal

Time on Water: 3 weeks

Calculation: $(3 \text{ weeks} / 52 \text{ weeks}) * .04 * 1.50 * 100 = .35 \text{ c/gal}$

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-5

Ref: Page 8.

- a. Please indicate how the federal ethanol mandates in 2006 will affect the import parity price of gasoline into Hawaii.
- b. Please also provide any recommendations as to how the Gas Cap formula should be adjusted to reflect the ethanol mandate.

Response:

- a) Neither the ICF recommendations nor the Legislated recommendations would change, as currently defined, when the ethanol mandates take place in 2006.
- b) There are a number of considerations and issues that need to be resolved and/or defined before this can be effectively answered. ICF's thoughts on these issues are noted below:
 - a. The production of gasoline in Hawaii would need to change from conventional at 87 octane (for Unleaded) and 11.5 RVP, to a lower octane and RVP to accommodate the impact of higher octane and RVP of ethanol. This would likely be a higher cost for refiners.
 - b. The Legislation (ICF understand) requires ethanol in 85% of Hawaii's gasoline, possibly requiring multiple levels of finished gasoline production to also produce gasoline at current specs.
 - c. The cost of gasoline to marketers would be a mix of ethanol and the sub-octane blend. The cost of ethanol would depend on the source. The original intent (ICF believes) was that Hawaii would produce adequate ethanol in the zones to provide local supply. Feedback which came to ICF in the sessions on May 18-20 indicate this is lagging badly and that imports may be required to meet the mandate. This implies that the ethanol "cost" determinant of the gasoline price cap will neither be transparent nor stable, and is a concern.
 - d. To the degree ethanol must be imported, the freight for the ethanol, while only 15% of the blend, will be difficult to estimate for the gas cap formula.
 - e. The source price for the sub-octane product in the US Gulf Coast and Singapore will also have to be adjusted from the Platt's quote. Platt's does post an RBOB price in the USGC which could be used as a basis, and Caribbean refiners do supply RBOB into the East Coast market.

ICF believes that any analysis of this would be difficult and to some degree subjective due to the fact that the actual sources and cost of the ethanol are uncertain and may change. Refiners and

marketers are likely in the best position to assess this issue, since they should be in the process of formulating implementation plans.

Hawaii is in a position where the timing of both mandates (the gas cap law and the ethanol) are creating extraordinary and legitimate concern among marketer and refiners. ICF believes that the analysis could take six months, and even at that the results would still be somewhat subjective and open for argument. The ethanol legislation will be more expensive for Hawaii marketers, and the supply chain more fragile, if imports are required versus state production. Any analysis would really need to understand the issues around growing domestic supply quickly, as well as the import issues.

Given the above issues, one approach would be an interim period of monitoring of the gas cap formula results, and publishing wholesale prices in the zones, until the ethanol mandate is implemented and supply of ethanol is stabilized. The transparency of the prices and the publication of the caps would enable all Hawaii stakeholders to become more familiar with the issues and determine the long term need for caps.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-6

Ref: Page 8.

- a. Please indicate how the federal ethanol mandates in 2006 will affect marketing costs.
- b. Please also indicate whether the price caps should be adjusted to reflect incremental marketing costs associated with ethanol blended gasoline. If so, please indicate how such an accommodation could be achieved.

Response:

- a) ICF believes the ethanol mandate will increase marketing costs by requiring additional capital investment for ethanol storage, segregation, and blending, as well as testing, trucking, barging and other operational costs (oversight, etc).
- b) The current structure of the gas cap formula will enable marketers to recover the cost of the ethanol investment by the process of annual updates in zone factor adjustments based on actual costs. These adjustments could take up to 2 years to be fully integrated into the gas cap formula, and they will increase the zone adjustments by the average of all market participants' cost.

Altering the process to integrate the costs earlier is a possibility, but it would have to be done carefully to protect confidential investment costs of each participant, and would require PUC and possibly Legislative concurrence.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-7

Ref: Page 24.

- a. Please state whether, in ICF's opinion, a premium should be added to the Platt's Singapore price recognizing that gasoline produced in the Far East could have quality characteristics, which do not fully align with U.S. or Hawaii conventional gasoline.
- b. If yes, please explain how this should be accomplished.

Response:

ICF does not believe that is necessary at this point. ICF believes the current Singapore product specifications indicate that there could be advantages (RVP) and costs (sulfur, benzene) that would occur for Far East refiners in making Hawaii grade gasoline. With current Hawaii specs, ICF believes there is no clear reason to adjust.

However, as noted, a change may be required with the ethanol mandate. It is also possible a change may be needed when the US converts to 30 ppm sulfur gasoline for all production and imports (2006). Analysis and/or input from Hawaii refiners would be needed to determine this impact.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-8

Ref: Page 34.

- a. Please state whether, in ICF's opinion, a cap is needed on the bulk sales class of trade.
- b. Please also indicate whether, in ICF's opinion, such a bulk sales cap would further the intent of the legislation.
- c. Please also indicate whether, in ICF's opinion, such a bulk sales cap is likely to cause pricing anomalies and legal problems with existing contracts.
- d. Please also state whether, in ICF's opinion, such a bulk sales cap is consistent with multiple sales within the bulk class of trade.

Response:

- a) ICF included a Bulk sales cap in the Report because it is a clear separate channel of wholesale trade was not apparently defined in the Legislation. Review of existing company bulk contracts and the existence of multiple back-to-back bulk trades in the Hawaii market lead ICF to conclude that the Bulk class of trade cap would not further the intent of the Legislature.
- b) It is ICF's opinion that a bulk sales cap would not further the intent of the legislation.
- c) It is ICF's opinion that a bulk sales cap is likely to cause pricing anomalies and legal problems with existing contracts.
- d) The bulk sales cap would not be consistent with multiple sales within the bulk channel.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-9 Ref: Page 39.

"Please provide the percentage split between branded and unbranded rack sales in Hawaii."

Response: ICF was not able to determine this breakdown.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-10

Ref: Page 39

- a. Please state whether, in ICF's opinion, for the purposes of the law a distinction between the branded and unbranded rack sales classes of trade is necessary.
- b. Please also indicate whether, in ICF's opinion, such a distinction between the branded and unbranded rack sales classes of trade would further the intent of the legislation.

Response:

- a) ICF clarified a difference in the cap based on an assumption that sufficient Unbranded Rack sales occurred in Hawaii that marketers would need similar flexibility to mainland marketers to (at times) price the Unbranded channel above Branded to manage supply. Based on discussions with Parties in May, it is possible that the Unbranded Rack channel may not behave in a similar manner to the mainland. In this case, the Unbranded Rack channel could be eliminated from the Gas Cap formula
- b) As noted in a), this distinction may not further the intent of the legislation.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-11 Ref: Page 40.

"Please state whether, in ICF's opinion, the price caps and station rent caps together might:"

- a. render some stations uneconomic; and
- b cause some locations to lose service.

Response:

- a) ICF did not evaluate the Retail service station business. ICF's understanding was that the rent caps may help make service station dealers profitable (since the service station supplier and owner are limited on the rent that the dealer can be charged). The gas caps are only on wholesale, so the service station profitability would appear to be unchanged to potentially better.
- b) ICF has not studied and won't comment on the rent cap impact on locations potentially losing service. The gas caps, as noted in ICF's Report Report, could cause a supplier to elect not to supply a station if they cannot recover their cost to deliver to the station.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-12

Ref: Page 40.

"Please indicate whether, in ICF's opinion, there is a higher risk that remote locations might become uneconomic and lose service."

- a. If ICF does see a risk that stations may become uneconomic and close, please explain under what circumstances that might occur.
- b. Please also indicate whether ICF has any recommendations for the PUC to prevent or at least minimize any loss of service that might occur.

Response:

- a) Yes, ICF sees a risk, as noted in IR-11. The circumstances would be ones where small marketers are supplying stations where the cost to supply is higher than the zone average, and the marketer/supplier is capped at the price they can charge the service station owner. In this case, the marketer/supplier may see no way to recover costs, and cancel the supply contract.
- b) There is no easy solution for the PUC to consider. Adding zones is one option, but may require Legislative intervention, and it may never end. Implementing a "gas cap monitoring and publication" system rather than a hard compliance system may be an alternative.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-13

Ref: Page 40

"Please state whether, in ICF's opinion, the recommended DTW price caps should be revised to reflect station rent caps that do not exist in benchmark Mainland markets. If yes, please explain how this should be accomplished."

Response:

ICF believes this is an area which represents a step change in cost for the Hawaii market that the mainland regions evaluated in the Report do not include. ICF believes this should be an adjustment.

The method to accomplish this would be to assess the overall impact of the rent caps on Hawaii marketers and suppliers, and to determine the additional cost of this versus mainland locations. Each marketer may have different impact levels, and the adjustment may be different for both Rack and DTW marketers. It may require input from parties' to assess this impact, and a decision to make a base adjustment to each channel of trade (Rack and DTW). ICF would NOT recommend "doubling" this adjustment, since it represents a single step change in the Hawaii market.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-14

Ref: Page 40.

"Please state whether, in ICF's opinion, a factor adjustment should be applied to the recommended DTW price caps to reflect the higher retail capital requirements in Hawaii relative to benchmark Mainland markets. If yes, please explain how this should be accomplished."

Response:

No. ICF has not seen adequate evidence that Hawaii's retail capital expenditures (ICF assumes this is for station appearance, car washes, modernization, service bays, C-stores, etc) should be passed on through higher gas caps. These investments are made with intent to generate additional volume, preserve volume, and attract other sources of revenue. The normal intent of these investments is not to increase price.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-15

Ref: Page 40.

- a. Please state whether, in ICF's opinion, the PUC should consider adjusting marketing margins on a monthly (versus annual) basis.
- b. Please indicate whether, in ICF's opinion, monthly adjustments would do a better job of mirroring competitive market conditions than annual adjustments.
- c. Please indicate whether, in ICF's opinion, there is any benefit or detriment in reflecting seasonal volatility that may be experienced in the mainland markets used to determine the Hawaii marketing margins.

Response:

- a) ICF does not believe so.
- b) It would do a better job of mirroring competitive market conditions than annual adjustments. ICF believes that would, in fact, be the problem with doing them monthly.
- c) ICF believes that the seasonal volatility is a detriment to using monthly margins. ICF also believes that the general volatility that can occur in marketing margins during periods of disruption or surplus can create month-to-month impacts in Hawaii that may make it difficult for marketers to effectively plan and manage their business and pricing strategy.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-16

Ref: Pages 49 and 79.

- a. Please state whether, in ICF's opinion, a price cap is needed on premium grade and mid-grade gasoline.
- b. Please also indicate whether, in ICF's opinion, such grade caps would further the intent of the legislation.

Response:

- a) Yes, ICF believes they are necessary.
- b) ICF believes it does. Not capping these grades could result in adverse effects on Hawaii consumers in terms of price, as well as perspective on the need to burn higher octane grades.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-17

Ref: Pages 8 and 61

- a. Please indicate how the federal ethanol mandates in 2006 will affect distribution costs.
- b. Please also indicate whether, in ICF's opinion, the zone price adjustment process needs to be revised to allow for an early adjustment to reflect incremental distribution costs associated with ethanol-blended gasoline. If yes, please indicate how such an accommodation could be achieved.

Response:

- a) ICF's answer to IR-6 addresses this, ICF believes. ICF would additionally note that the distribution cost may change as Hawaii moves from importing ethanol to using home-grown product.
- b) In almost all cases of regulatory implementation of ethanol, there is no mechanism for suppliers or marketers to recover costs. However, other markets converting to ethanol allow the option of prices to rise to cover those costs (which they may or may not do).

With gas caps in place, it makes sense, in ICF's opinion to incorporate the incremental costs. Accelerating the adjustment to recover these costs may not be the most effective way to accurately capture these costs in the gas cap. Estimated capital costs and operational costs may turn out differently, and in all cases the costs for implementation would need to be averaged. The timing of when this could be done would have to be assessed.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-18

Ref: Page 61.

"Please indicate whether, in ICF's opinion, there is a way to apply PUC approved rates as a proxy for trucking costs incurred in DTW sales rather than estimates of high/low and/or average trucking costs supplied by companies. If yes, please explain how this should be accomplished."

Response: No, ICF does not believe so. ICF examined the PUC trucking tariffs and of course they are for specific point to point movements. They also do not apply to any company moving product on their own trucks.

Use of the specific PUC tariffs would imply that all volume moved was at the PUC tariff, and that the specific volume to each delivery point (and size truck, etc) would need to be assessed to determine an overall average. Simply asking companies for their average costs appeared to be the ideal approach. In future updates, ICF would specifically ask for average trucking costs per gallon in each zone (i.e. eliminating the need to assess percentages at high and low cost)

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-19

Ref: Page 61.

"Please indicate whether, in ICF's opinion, the price caps should make any accommodation for shippers who deliver to Hawaii in double-hulled barges that are not yet mandated, if the additional costs of such shipping are properly identified."

- a. If yes, please indicate how such an accommodation should be achieved, such that shippers using single-hulled barges do not benefit from an increase in average barging costs by way of the zone cost adjustments.

Response:

This question is not straightforward to address. Pre-investing in double hulled barges can be a decision made for strategic/environmental reasons, or because a transporter may not be able to avoid replacement before the 2015 double hull requirement date.

Barge companies who service Hawaii marketers will likely pass their costs on when they occur as part of their contractual updates. Companies who own their own barges will (ICF thinks) begin reporting these costs as money is being spent to secure the equipment. The normal process of annual reporting of costs should capture all these factors, albeit delayed.

ICF believes that this process will capture all double hull barge costs over time, and therefore provide a mechanism to include these costs in the formula. ICF notes that (as far as ICF knows), all other expenses to convert to double hull equipment in non-gas cap markets has no such guarantee that costs can be recovered.

Sponsor: Thomas W. O'Connor

**ICF CONSULTING LLC RESPONSE TO CONSUMERS ADVOCATE INFORMATION
REQUESTS**

Docket #05-0002

CA-IR-20

Ref: Exhibit 6.1, Page 62.

- a. Please confirm that the total zone adjustment for zone 4 Maui (Hana) includes the same barge and terminal costs as zone 3 Maui (Kahului) and that the difference in total zone adjustments between zones 3 and 4 is based on trucking costs.
- b. Please provide a breakdown of the barge, terminal, and truck costs for zones 4 Maui (Hana), 5 (Molokai), and 6 (Lanai).

Response:

- a) Zone 3 and zone 4 have the same barge and terminal costs, and the difference in total zone adjustments between zones 3 and 4 is based on trucking costs.
- b) This information is located in the Redacted Data files "Consumer Advocate D6.3 Total Zone Pricing Adjustments by Grade and Sales Type 4-7-05" which has been separately provided. (Worksheet tab "Adjustment Factors")

Sponsor: Thomas W. O'Connor

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Responses to Information Requests upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.


DIVISION OF CONSUMER ADVOCACY
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
P. O. Box 541
Honolulu, HI 96809

MICHAEL H. LAU, ESQ.
KENT D. MORIHARA, ESQ.
ISHIKAWA MORIHARA LAU & FONG LLP
841 Bishop Street, Suite 400
Honolulu, HI 96813

CRAIG I. NAKANISHI, ESQ.
RUSH MOORE LLP
737 Bishop Street, Suite 2400
Honolulu, HI 96813

CLIFFORD K. HIGA, ESQ.
BRUCE NAKAMURA, ESQ.
KOBAYASHI, SUGITA & GODA
First Hawaiian Center
999 Bishop Street, Suite 2600
Honolulu, HI 96813

KELLY G. LAPORTE, ESQ.
MARC E. ROUSSEAU, ESQ.
CADES SCHUTTE LLP
1000 Bishop Street, Suite 1200
Honolulu, HI 96813



Kevin M. Katsura

DATED: June 17, 2005